

FILED
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1941

No. 238

THE UNITED STATES OF AMERICA,

Petitioner,

vs.

STATE OF NEW YORK.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT
OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF FOR THE STATE OF NEW YORK.

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Opinions Below.

The second opinion of the District Court for the Western District of New York (R. 13-18) is unreported. The first opinion of that court is reported in 28 F. Supp. 428. The opinion of the Circuit Court of Appeals (R. 25-30) is reported in 118 F. (2d) 537.

Jurisdiction.

The judgment of the court below was entered April 12, 1941 (R. 31). The petition for a writ of certiorari was filed July 5, 1941, and granted October 13, 1941. The jurisdiction of this Court rests upon § 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

Summary of Argument.

Section 801 of the Social Security Act imposes a tax upon the income of employees in employment as defined in the Social Security Act. Section 802 (a) which requires the employer of the taxpayer, the employee, to deduct from his wages the amount of the tax, does not make the employer liable for a tax as a taxpayer but rather for a debt as a collecting agent of the United States. A decision of this Court in *City of New York v. Feiring*, 313 U. S. 283 is not applicable to the issue here involved since the incidence of the tax imposed by § 801 of the Social Security Act is solely on the employee while the incidence of the tax imposed in the *Feiring* case was on both the vendor and the vendee.

ARGUMENT.

The claim of the United States for taxes imposed upon employees of this bankrupt under Title VIII, § 801 of the Social Security Act, is not entitled to priority under § 64 (a)(4) of the Bankruptcy Act.

Section 801 of the Social Security Act, which was in effect during 1937, provided in part as follows:

"Sec. 801. In addition to other taxes, there shall be levied, collected and paid upon the income of every individual a tax equal to the following percentages of the wages (as defined in section 811) received by him after December 31, 1936, with respect to employment (as defined in section 811) after such date:

(1) With respect to employment during the calendar years 1937, 1938, and 1939, the rate shall be one per centum. * * *

Section 802 (a), as in effect in 1937, provided that:

"The tax imposed by section 801 shall be collected by the employer of the *taxpayer*,¹ by deducting the amount of the tax from the wages as and when paid. Every employer required so to deduct the tax is hereby made liable for the payment of such tax, and is hereby indemnified against the claims and demands of any person for the amount of any such payment made by such employer."

It is submitted that this is not a tax upon *the bankrupt*, but a tax upon the *employees of the bankrupt*, and, therefore, is not entitled to priority within the plain meaning of § 64 (a) (4) of the Bankruptcy Act.

Under the Social Security Act, *supra*, the employer is required to deduct the tax assessed upon the employee from the employee's wages and remit to the United States Treasury Department. The employer is constituted a tax collector for the United States. The amount so collected or required to be collected becomes a debt owing to the United States instead of a tax due from the employer. In *Nolte v. Hudson Navigation Co.*, 8 F. (2d) 859, the United States claimed priority with respect to moneys which were collected by the Navigation Company under the provisions of Title 5 of the Revenue Act of October 3, 1917 (40 Stat. 314) and of the Revenue Act of 1918 (Comp. St. Ann. Supp. 1919, §§ 6309 1/3 a-6309 1/3 e). At page 862 therein the Court stated:

"Those acts imposed a tax upon persons and property for their transportation from one point in the United States to another. The language of the act is:

¹ Italics, when used, are our own.

'That the taxes imposed . . . shall be paid by the person, corporation, partnership, or association paying for the services or facilities rendered.' Section 501. It laid the duty of collecting the tax upon the carrier rendering the service, and made it the duty of the carrier to make monthly returns under oath, 'and pay the taxes so collected and the taxes imposed . . . to the collector [of internal revenue] of the district in which the principal office or place of business is located.' Section 503. And the act of 1918 declared that, 'if the tax is not paid when due, there shall be added as part of the tax a penalty of 5 per centum, together with interest at the rate of 1 per centum for each full month, from the time when the tax became due.' 40 Stat. 1103, § 502 (Comp. St. Ann. Supp. 1919, § 6309 1/3c).'"

The United States contended there that the obligation of the Navigation Company was a tax obligation and consequently it was entitled to the lien afforded by § 3186 of the Revised Statutes. The Court, in holding that the Company's obligation was a debt and not a tax, said at page 862:

"It seems to us too clear for argument that the acts of Congress involved herein impose a tax upon the person transported or upon the shipper of freight to be carried. The tax is not imposed on the carrier but on the person or thing carried. And it is equally clear that the carrier is made a collector of the tax, and the duty is laid upon it to pay the amount which is thus collected to the collector of internal revenue of the district in which the carrier has its principal office or place of business.

"A tax is a pecuniary burden imposed for the support of government. The courts have said again and again that a tax is not a debt nor in the nature of a debt. It is not, as is a debt, founded on contract or agreement. It is an impost levied by authority of the government upon its citizens or subjects for the sup-

port of the state. The taxpayer is the one upon whom the pecuniary burden is imposed and whose duty it is to make payment. The burden of making payment here rests on the traveler or shipper. The duty of collecting it and then paying over the amount collected rests on the carrier it is true, but this does not make the carrier a taxpayer as distinguished from a tax collector."

In re York Silk Mfg. Co., 192 F. 81, the same doctrine was affirmed by the Circuit Court of Appeals in the Third Circuit. (Appeal dismissed for want of jurisdiction by this Court in 232 U. S. 718 and certiorari denied in 323 U. S. 724.) In that case the Circuit Court of Appeals said:

"By a statute of the state of Pennsylvania it is made the duty of the treasurer of a corporation, upon the payment of interest on any bond of the corporation, if the holder be a resident of Pennsylvania, to deduct from the interest the tax imposed by the state upon such bond and pay the same into the state treasury. This is a tax against the holder of the bond, and not against the corporation. The corporation, acting through its treasurer, is charged with the duty of collecting the tax and paying it over to the state. If it fails so to do, it becomes liable to the state for the amount of the tax and the penalty prescribed. * * * But there is nothing in the law giving to the state a preferred claim against the corporation whose treasurer has failed to collect the tax or to pay it over to the state."

The obligation of the bankrupt employer in the instant case was identical with that of the corporation in the *York* case, *supra*. The statute there made it the duty of the treasurer of the corporation, upon payment of interest on any bond of the corporation, to deduct from such interest the tax imposed by the State upon the bond and to pay the same into the State Treasury. Section 802 (a) of Title 8 which is here involved, requires the employer to deduct the amount of the tax from the wages of the taxpayer, and

similar to the statute in the *York* case, upon failure so to do, it becomes liable for the payment of such tax.

See, also, *Colorado Bank v. Bedford*, 310 U. S. 41, where this Court held that a tax upon safe deposit rentals collected by a bank was not a tax upon the bank but upon customers of the bank.

In *Gulf Oil Corporation v. Grady*, 110 Fed. (2d) 178, the Court held that an estate of a bankrupt is not liable for the payment of a tax on gasoline bought from a distributor where the New York statute expressly declared that the distributor was to be the taxpayer. The claim was denied priority under § 64 of the Bankruptcy Act as amended, but was allowed as a general claim, the Court holding that "the debt which the bankrupts here owe the appellant is not one 'legally due and owing by the bankrupt . . . to any State'; for in any event, the bankrupt could not be considered the primary taxpayer."

The petitioner herein places such reliance upon the decision of this Court in *City of New York v. Feiring, supra*, that it claims the decision below should be reversed upon that authority. The *Feiring* case is clearly distinguishable from the situation presented herein. The *Feiring* case dealt with the New York City Sales Tax Act which by its terms imposed a tax both upon the vendor and the vendee. In our case, however, the tax is an income tax levied solely on the employee which is to be collected by the employer and paid by the employer to the Federal government. In our case, unlike the situation in the *Feiring* case, the tax is not levied upon both the employee and the employer. It is necessary to consider Title VIII of the Social Security Act in its entirety. Two taxes, separate and distinct, are levied under Title VIII, one an excise tax levied against

the employer based upon his payroll (§ 804) and the other an income tax levied against the employee based upon his wages in employment as defined (§ 801). Section 802 (a) describes the "employee" as the "taxpayer" of the tax imposed by § 801, and by its very terms constitutes the employer an insurer of collection and no more. Unlike the New York City Sales Tax Act where the incidence of the tax was, as this Court pointed out, laid jointly on the vendor and the vendee, the incidence of the tax imposed by § 801 is *solely* upon the employee.

Section 807 of the Federal Social Security Act² provides that the taxes imposed shall be collected by the Bureau of Internal Revenue under the direction of the Secretary of the Treasury and shall be paid into the Treasury of the United States as internal revenue collections.

Section 808, *ibid.*³ provides that the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall make and publish rules and regulations for the enforcement of this Title. Under this authority, in addition to regulation 91, Article 505, regulation 106, § 402.304 has been promulgated which provides that "Until collected from him the employee is also liable for the employees' tax with respect to all the wages received by him." Thus it is clear that the liability of the employee to pay his income tax is not dischargeable until the employer has collected it from the employee. We submit that the decision in the *Feiring* case is not applicable to the issue herein and that the obligation of the bankrupt employer is a debt and not a tax.

² Superseded by § 1420 (a)-(b) Internal Revenue Code.

³ Superseded by § 1429 Internal Revenue Code.

Conclusion.

For the above reasons, it is submitted that the judgment of the Circuit Court of Appeals should be affirmed with respect to the claim of the United States under §§ 801 and 802 (a) of the Social Security Act.

Respectfully submitted,

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January, 1942.

APPENDIX.

Social Security Act, c. 531, 49 Stat. 620:

(U. S. C. Supp. V, Title 42, Sec. 1001.)

SECTION 801. In addition to other taxes, there shall be levied, collected, and paid upon the income of every individual a tax equal to the following percentages of the wages (as defined in section 811) received by him after December 31, 1936, with respect to employment (as defined in section 811) after such date:

(1) With respect to employment during the calendar years 1937, 1938, and 1939, the rate shall be 1 per centum.

(U. S. C. Supp. V, Title 42, Sec. 1004.)

SEC. 802. (a) The tax imposed by section 801 shall be collected by the employer of the taxpayer, by deducting the amount of the tax from the wages as and when paid. Every employer required so to deduct the tax is hereby made liable for the payment of such tax, and is hereby indemnified against the claims and demands of any person for the amount of any such payment made by such employer.

(U. S. C. Supp. V, Title 42, Sec. 1004.)

SEC. 804. In addition to other taxes, every employer shall pay an excise tax, with respect to having individuals in his employ, equal to the following percentages of the wages (as defined in section 811) paid by him after December 31, 1936, with respect to employment (as defined in section 811) after such date:

(1) With respect to employment during the calendar years 1937, 1938, and 1939, the rate shall be 1 per centum.

(2) With respect to employment during the calendar years 1940, 1941, and 1942, the rate shall be 1½ per centum.

(3) With respect to employment during the calendar years 1943, 1944, and 1945, the rate shall be 2 per centum.

(4) With respect to employment during the calendar years 1946, 1947, and 1948, the rate shall be 2½ per centum.

(5) With respect to employment after December 31, 1948, the rate shall be 3 per centum.

(U. S. C. Supp. V, Title 42, Sec. 1006.)

SEC. 807. (a) The taxes imposed by this title shall be collected by the Bureau of Internal Revenue under the direction of the Secretary of the Treasury and shall be paid into the Treasury of the United States as internal-revenue collections. If the tax is not paid when due, there shall be added as part of the tax interest (except in the case of adjustments made in accordance with the provisions of sections 802 (b) and 805) at the rate of one-half of 1 per centum per month from the date the tax became due until paid.

(U. S. C. Supp. V, Title 42, Sec. 1007.)

SEC. 808. The Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall make and publish rules and regulations for the enforcement of this title.

(U. S. C. Supp. V, Title 42, Sec. 1008.)

Bankruptcy Act of July 1, 1898, c. 541, 30 Stat. 544, as amended by Act of June 22, 1938, c. 575, 52 Stat. 840:

SEC. 64. DEBTS WHICH HAVE PRIORITY.—a. The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be (4) taxes legally due and owing by the bankrupt to the United States or any State or any subdivision thereof: *Provided*, That no order shall be made for the payment of a tax assessed against any property of the bankrupt in excess of the value of the interest of the bankrupt estate therein as determined

by the court: *And provided further*, That, in case any question arises as to the amount or legality of any taxes, such questions shall be heard and determined by the courts; • • •

(U. S. C. Supp. V, Title 11, Sec. 104.)

Treasury Regulations 91, promulgated under Title VIII of the Social Security Act:

ART. 505. *Assessment of underpayments.*—If any tax is not paid to the collector when due, the Commissioner may, as the circumstances warrant, assess the tax (whether or not the underpayment is otherwise adjustable) or afford the employer opportunity to adjust the underpayment pursuant to article 502 or 503. Unpaid employers' tax or employees' tax may be assessed against the employer. Employees' tax not collected by the employer may also be assessed against the employee. The unpaid amount, together with interest and penalty, if any, will be collected, pursuant to section 3184 of the United States Revised Statutes and other applicable provisions of law, from the person against whom the assessment is made. If any amount of an assessment has been previously reported and paid to the collector as an adjustment or otherwise, the person against whom the assessment is made is privileged to file with the collector a claim for abatement of such amount, together with interest and penalty thereon if included in the assessment. If an employer pays employees' tax pursuant to an assessment against him without an adjustment having been made pursuant to article 502, reimbursement is a matter to be settled between the employer and the employee. See article 602, relating to interest, and article 603, relating to penalty for failure to pay an assessment after notice and demand. See also article 601, relative to jeopardy assessments.

Treasury Regulations 106, promulgated under Sec. 1429 of the Internal Revenue Code:

SEC. 402.304. Collection of, and liability for, employees' tax.—The employer shall collect from each of his employees

the employees' tax with respect to wages for employment performed for the employer by the employee. The employer shall make the collection by deducting or causing to be deducted the amount of the employees' tax from such wages as and when paid, either actually or constructively. The employer is required to collect the tax, notwithstanding the wages are paid in something other than money (for example, wages paid in stock, board, lodging; see section 402.227) and to pay the tax to the collector in money. In collecting employees' tax, the employer shall disregard any fractional part of a cent of such tax unless it amounts to one-half cent or more, in which case it shall be increased to 1 cent. The employer is liable for the employees' tax with respect to all wages paid by him to each of his employees whether or not it is collected from the employee. If, for example, the employer deducts less than the correct amount of tax, or if he fails to deduct any part of the tax, he is nevertheless liable for the correct amount of the tax. Until collected from him the employee is also liable for the employees' tax with respect to all the wages received by him. Any employees' tax collected by or on behalf of an employer is a special fund in trust for the United States. The employer is indemnified against the claims and demands of any person for the amount of any payment of such tax made by the employer to the collector.

Section 2707 of the Internal Revenue Code (see page 87 of these regulations) provides severe penalties for a willful failure to pay, collect, or truthfully account for and pay over, the employees' tax or for a willful attempt in any manner to evade or defeat the tax. Such penalties may be incurred by any person, including the employer, and any officer or employee of a corporate employer, or member or employee of any other employer, who as such employer, officer, employee, or member is under a duty to perform the act in respect of which the violation occurs.